

**MINUTES
of the
SECOND MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**July 15-16, 2013
Room 307, State Capitol
Santa Fe**

The second meeting in 2013 of the Revenue Stabilization and Tax Policy Committee (RSTPC) was called to order by Senator Carlos R. Cisneros, chair, on Monday, July 15, 2013, at 10:05 a.m. in Room 307 of the State Capitol in Santa Fe.

Present

Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Rep. Anna M. Crook
Rep. Brian F. Egolf, Jr.
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. Thomas C. Taylor (7/16)
Sen. Lisa A. Torracio
Rep. Jim R. Trujillo
Sen. Peter Wirth
Rep. Bob Wooley

Absent

Sen. Sue Wilson Beffort
Sen. Timothy M. Keller
Rep. Henry Kiki Saavedra
Rep. James R.J. Strickler

Designees

Sen. William F. Burt
Rep. Jason C. Harper (attending as a
guest 7/16)
Rep. Tim D. Lewis (attending as a guest)
Rep. Dennis J. Roch

Guest Legislator

Rep. Nathan "Nate" Cote

(Attendance dates are noted for members not attending the entire meeting.)

Staff

Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS

Jennifer Dana, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, July 15

Review and Explanation of the New Mexico Jobs Package — HB 641 (2013)

Demesia Padilla, CPA, secretary, Taxation and Revenue Department (TRD), and John Tysseling, Ph.D., chief economist, TRD, provided the committee with a summary of the economic impacts of HB 641, which passed during the 2013 legislative session. The legislation will result in changes with respect to New Mexico's corporate income tax, certain gross receipts tax deductions, the high-wage jobs tax credit, the film tax credit and "hold harmless" distributions to certain local governments.

Beginning January 1, 2014, Dr. Tysseling explained, a reduction in the highest corporate income tax rate will be phased in over five years, from 7.6 percent to 5.9 percent. Effective July 1, 2013, corporations with retail facilities exceeding 30,000 square feet will be required to file corporate income tax returns using the combined reporting method. An exclusion from the requirement for combined reporting will be available to corporations that employ at least 750 workers in "non-retail" business activities. Secretary Padilla noted that the TRD intends to make regulatory changes to permit a corporation to change its filing methodology if it meets that threshold, yet previously elected to use the combined reporting methodology.

Next, Dr. Tysseling explained that HB 641 will permit a manufacturer to elect to apportion its business income to New Mexico using a single-weighted sales factor. This change will apply to 2014 and subsequent taxable years. The single-weighted sales factor will be phased in over a period of five years.

Dr. Tysseling provided the committee with a summary of forecasted impacts of HB 641 to corporate income tax receipts. For fiscal year (FY) 2017, he projected that the corporate income tax rate reduction would have a negative impact of about \$70.5 million. The implementation of the single-weighted sales factor for manufacturers would have a negative impact of about \$45.3 million. The requirement for combined reporting for certain unitary corporations would have a positive fiscal impact of approximately \$4.2 million.

Dr. Tysseling spoke about the impact of changes to local governments' "hold harmless" distributions. The "hold harmless" distributions are made to compensate local governments for revenue reductions due to the implementation of the gross receipts tax deductions for food and

medical services. The legislation would phase out the "hold harmless" distributions for certain local governments over a period of 15 years.

Certain local governments could continue to receive "hold harmless" distributions. A municipality with a population of less than 10,000 would continue to receive the distributions if it does not impose an additional gross receipts tax, often referred to as a "hold harmless gross receipts tax". That tax may be imposed, by ordinance, in an amount up to three-eighths percent of the local option gross receipts tax. The "hold harmless gross receipts tax", as it is intended, would offset the funds that would no longer be received by a municipality or county due to the phaseout of the "hold harmless" distribution. A county with a population of less than 48,000 would continue to receive its "hold harmless" distribution if it does not impose a "hold harmless gross receipts tax".

Secretary Padilla cautioned that smaller local governments should be mindful of the unintended consequences that might stem from imposition of a "hold harmless gross receipts tax". A small local government might face adverse consequences if losses from elimination of the "hold harmless" distributions outweigh the positive revenue impacts from imposition of the "hold harmless gross receipts tax". Secretary Padilla said that the TRD is willing to work with local governments and the Department of Finance and Administration (DFA) to gauge the potential impacts of such an imposition. Dr. Tysseling forecasted that in FY 2017, the general fund will enjoy a positive fiscal impact of approximately \$15.7 million as the result of reduced "hold harmless" distributions to local governments.

Dr. Tysseling also spoke about the impact of the legislation's definition of a "consumable" in the context of a gross receipts deduction for sales to manufacturers. Effective July 1, 2013, a "consumable" would include tangible personal property, including electricity, fuels, water, manufacturing aids and supplies, chemicals, gases, repair parts, spares and other tangibles used to manufacture a product. The definition specifically excludes tangible property used in the generation of power, the processing of natural resources and the preparation of meals for immediate consumption. Secretary Padilla added that since the legislation passed, about 70 firms have submitted applications for Type 12 nontaxable transaction certificates, which are used as evidence of eligibility for the deduction. She stated that larger entities will tend to benefit the most from the deduction. Dr. Tysseling noted that the restrictions now explicit with the definition of "consumable" are forecasted to have a positive fiscal impact in FY 2014 of about \$16.9 million.

Dr. Tysseling summarized the various changes to the high-wage jobs tax credit, which became effective June 14, 2013. He summarized the clarifications made to the existing law and the credit's extension for an additional five years. He mentioned that the wage threshold for a job to be considered eligible for a credit under the new law has increased. The wage threshold for new, high-wage jobs created after July 1, 2015 will increase to \$40,000 for jobs created in areas outside of municipalities and to \$60,000 for areas within municipalities. Dr. Tysseling explained that another key component of the new credit excludes a job from credit eligibility if the job is

related to a business merger, acquisition or other change in organization. Secretary Padilla noted that in light of impending, stricter provisions for credit qualification, the TRD received a number of applications for the credit before the effective date of the new requirements. Secretary Padilla highlighted other changes that will result from the implementation of the new law, including limitations during which the high-wage jobs tax credit must be claimed. Dr. Tysseling projected that the modifications to the high-wage jobs tax credit would have a positive general fund impact of about \$6.4 million in FY 2014, with a positive impact of approximately \$19.6 million in FY 2015.

Dr. Tysseling discussed the legislation's changes to the film tax credit that allow an additional five percent credit for television shows, subject to certain requirements. The new law also permits up to \$10 million of an unused portion of the \$50 million cap on the film production tax credit to be carried forward and added to the subsequent fiscal year's film production tax credit cap. The law also modifies the manner of scheduled payments of multiyear credit claims with respect to years in which the \$50 million credit is not reached. In addition, the law imposes more specific requirements for withholding taxes related to services provided by artists and clarifies tax obligations for nonresident vendor services.

Finally, Dr. Tysseling provided the committee with a summary of the recurring revenue impacts of HB 641. By FY 2017, the negative fiscal impact to the general fund would be \$70 million. Considering revenue impacts to local governments, the Small Counties Assistance Fund and the municipal equivalent distribution, the overall fiscal impact approximates \$68 million.

Committee members discussed a number of issues with Secretary Padilla and Dr. Tysseling, including:

- concerns about the state's ability to bear the \$70 million general fund fiscal impact over a period of four years;
- the impact of the changes to existing "hold harmless" provisions on municipalities whose populations are soon expected to exceed 10,000;
- whether the "hold harmless tax" must be used in a manner similar to the use of the "hold harmless" distributions;
- whether there is a correlation between reduced corporate income tax rates and job creation;
- strategies, outside of tax policy, that might be used to attract businesses to the state;
- a strategy to comprehensively examine all taxes to achieve the goal of revenue stabilization; and
- the impact of the ability to impose the "hold harmless tax" and loss of "hold harmless" distributions on small and large municipalities.

Approval of Minutes

The committee, without objection, approved the minutes of the first meeting of the RSTPC held on May 14, 2013.

Comparing New Mexico's Tax Structure to Other States — An Overview

Richard Anklaam, president and executive director, New Mexico Tax Research Institute (NMTRI), provided a comparison of New Mexico's tax structure to the tax structures of other states. He first provided an overview of states that do not impose certain taxes. He noted that New Hampshire, Oregon, Montana, Alaska and Delaware do not impose sales taxes. He added that Florida, Nevada, South Dakota, Texas, Washington and Wyoming do not impose personal income taxes. He also stated that Nevada, Ohio, South Dakota, Texas, Washington and Wyoming do not impose corporate income taxes. When a state does not impose a "primary tax", Mr. Anklaam indicated, the state will often have a substitute tax program in place. For example, Ohio, Washington and Texas impose broad business activity taxes, such as gross receipts taxes, in lieu of corporate income taxes.

Mr. Anklaam expressed that a comparison of state tax programs must involve more than a comparison of tax rates. He said that a number of other factors should be considered, including the composition of the tax base and the relative impacts of credits, incentives and other adjustments. Mr. Anklaam indicated that states impose a vast range of general and narrow tax programs, which are designed around their economies and to fund their operations.

Relative to other states, Mr. Anklaam stated that New Mexico imposes a fairly high tax burden on new business investment. In particular, New Mexico has a broad-based gross receipts tax on business inputs, including services. According to Mr. Anklaam, gross receipts tax rates tend to rise, which could further magnify the impacts of tax pyramiding and regressivity.

Another tax affecting new businesses is the corporate income tax. Mr. Anklaam explained that New Mexico's corporate income tax rate of 7.6 percent is higher than the average rate of 6.7 percent. He additionally stated that New Mexico offers no real tax incentives for exporters outside of the standard three-factor formula for apportionment of income.

Mr. Anklaam also compared New Mexico's property taxes and personal income taxes to those same taxes imposed in other states. While New Mexico is characterized by low property tax rates among the states, property tax rates imposed in Albuquerque are close to the national average. With regard to the personal income tax, Mr. Anklaam noted that the top rates are reached at lower income levels. Although New Mexico's average personal income tax rate is lower than the national average, the state's average rate is still comparable to surrounding jurisdictions that impose income taxes, except California. Mr. Anklaam added that the 50 percent exclusion for capital gains income in New Mexico is more generous than similar capital gains provisions in other states. Mr. Anklaam next presented a table comparing New Mexico's tax revenues from different tax programs as a percentage of the gross state product (a state's

counterpart to a country's gross domestic product) to the average tax revenues from the similar tax programs among the other states.

Mr. Anklam described the results of a new study published by the Council on State Taxation (COST). The study was initiated to examine returns on investment for corporations in five different sectors within the context of the tax structures of all 50 states and the District of Columbia. The study ranked the states with respect to the calculated returns on investment. According to the study, the top performers were Maine, Oregon, Ohio and Wisconsin. The states that ranked the lowest included Kansas, Rhode Island and New Mexico and the District of Columbia. Mr. Anklam emphasized that the study had some limitations. For instance, he noted, the study did not consider state tax incentives and used limited corporate income assumptions.

Mr. Anklam explained how incentives, such as statutory credits, may reduce the total state and local effective tax rates. He indicated that if those incentives are considered across all industries, a 60 percent reduction in the total state and local effective tax rate could result. Mr. Anklam next presented a table comparing New Mexico's average and effective state and local business tax rates net of tax credits. In the services business sector, New Mexico had the eighth-highest effective tax rate. In the manufacturing sector, New Mexico had the third-highest effective tax rate, and across all industries, New Mexico had the sixth-highest effective tax rate.

Mr. Anklam briefly reviewed another study by the Tax Foundation, a nonprofit organization. That study ultimately resulted in the development of a "state business tax climate index" meant to compare the business tax climates of the states. In that study, New Mexico ranked thirty-eighth.

Mr. Anklam indicated that comparative studies are effective when they compare after-tax returns on investment, but they are also assumption-driven. Mr. Anklam stated that it is important to understand the assumptions and the goals of the information sources with respect to such studies.

Senator Cisneros invited Mr. Anklam to attend the committee's future meetings and provide additional information on tax reform issues. The committee members then discussed possibilities for the study of the economic development performance of other states relative to the taxes imposed by those states.

Cultural Affairs Department: Selected Capital Outlay Projects

Jeff Canney, program evaluator, Legislative Finance Committee (LFC), presented the results of the LFC's evaluation of specific capital outlay appropriations and the funding process by which the Cultural Affairs Department (CAD) supports its capital projects and other needs. Overall, the LFC concluded that the dedicated funding to maintain CAD properties is inadequate, thus requiring the CAD to request additional capital outlay funding each year. Mr. Canney noted that capital outlay requests are not a sustainable solution to the CAD's ongoing needs. Mr.

Canney elaborated on a number of key findings and recommendations developed during the course of the LFC's evaluation.

Mr. Canney indicated that, as a result of its evaluation, the LFC found that the CAD does not use a credible statewide maintenance and improvement plan to address critical needs. While the CAD relies on capital appropriations to address critical needs, that source of funding is not reliable for year-to-year demands. Moreover, the CAD does not have a formal capital outlay plan to prioritize critical needs, project accurate revenues and costs and plan for surpluses or shortfalls. Mr. Canney indicated that the CAD currently uses capital outlay funds to address emergencies on a case-by-case basis and that the CAD has underutilized its Capital Improvements Fund for museum repairs and improvements. He noted that the CAD holds \$1.3 million for museum and historic site capital improvements, which is at risk of reverting. Mr. Canney stated that the CAD's capital outlay request is not prioritized based on the greatest needs and is not supported by reliable estimates.

To address these issues, the LFC made a number of recommendations, including the development of a workable capital outlay plan that prioritizes capital repairs and improvements, reliably projects revenues and expenditures and plans for deficits or surpluses. The LFC recommends that the legislature identify a reliable and adequate funding source of museums and historic sites and consider placing CAD facilities under General Services Department (GSD) oversight.

Another key finding from the LFC's evaluation involved management issues with respect to a capital appropriation for the revitalization of a school house in Ribera, New Mexico. The school house had been gifted by the Los Pueblos Community Center (Los Pueblos) to the CAD, and in 2007, the state appropriated \$600,000 to plan, design, construct, renovate and preserve the school house. The CAD sold the school house back to Los Pueblos for \$39,000 after the appropriation was made and spent on various repairs and improvements to the school house. The TRD found that an independent appraisal of the property, which had assumed that the property was a vacant and unimproved lot since the repairs and improvements were not completed, reasonably supported the sale price, and the State Board of Finance (SBF) narrowly approved the sale. The LFC additionally found that the CAD contracted with Omni Development Corporation, a company convicted of embezzlement. In 2009, the CAD hired the company to perform carpentry services. The same company was debarred from six GSD contracts following its conviction. The LFC's evaluation additionally concluded that the CAD did not comply with the Procurement Code when it contracted with Omni Development Corporation because the contract was not the result of a competitive bidding process. Finally, Mr. Canney indicated that the CAD incurred inappropriate costs on the Ribera project.

Mr. Canney presented a number of recommendations to address these issues, including that the CAD follow the Procurement Code and require competitive bids for construction projects and professional services. The LFC further recommends that the CAD hold contractors accountable for deliverables and that the GSD expeditiously notify the Attorney General's Office

to enforce consequences for agencies, individuals and businesses that have not complied with the Procurement Code. Finally, Mr. Canney suggested that the SBF consider the value of improvements when it makes determinations regarding the sale of property.

Next, Mr. Canney discussed the details of the LFC's finding that the CAD does not effectively track New Mexico's art in public places. Since 1986, the state has appropriated more than \$19.7 million to provide art in public places; however, the database used to manage the Art in Public Places (AIPP) program is fragmented and does not produce reliable reports. An upgrade of the database is currently performed in-house without a formal information technology plan, and surplus amounts remaining after an AIPP project's completion are commingled with other auxiliary funds. The result is a lack of accountability and transparency. Finally, Mr. Canney indicated that the artwork owned by the CAD is not identified in the agency's financial audit.

The LFC recommends that the legislature limit the amount of administrative costs that may be charged against the AIPP Fund and makes the following key recommendations for the CAD:

- maintain inventory control for all artwork procured with public funds;
- prepare an information technology plan for the AIPP database and any new information technology project before the work begins; and
- reconcile the AIPP database against SHARE balances.

Additional recommendations are included in the LFC's evaluation report.

The LFC's last finding is that the CAD generally administers the library bond program effectively, despite some lack of expediency in spending. The library bond program has received \$11.7 million from state-appropriated and voter-approved general obligation bonds since 2009. From May 2011 to May 2013, only 11 percent of the statewide public library funds were expended, and less than one percent of FY 2011 amounts for tribal libraries were expended. Despite this issue, Mr. Canney concluded that the library bond program is administered transparently and benefits local and tribal communities. To improve spending expediency, the LFC recommends that the CAD revise administrative rules to require an encumbrance of capital outlay funds within 10 business days after a bond sale notice from the SBF.

Veronica Gonzales, secretary, CAD, thanked the committee for the opportunity to provide testimony in response to the LFC's report. Secretary Gonzales pointed to the CAD's response letter provided at the end of the LFC's evaluation report. Secretary Gonzales said that the CAD has taken a number of steps to address the issues identified by the LFC. She indicated that the CAD has:

- halted unfunded expansions characterized by a lack of planning and funding;
- divested the CAD of the Ribera school;

- hired a facilities manager;
- developed a condition assessment index for CAD facilities;
- developed a condition assessment database using best practices;
- initiated a capital outlay repair process to prioritize projects statewide and reduce risk; and
- worked with the DFA to ensure an expeditious use of capital outlay funds.

Secretary Gonzales emphasized that the exemption for GSD oversight over CAD facilities should be maintained. She said that since the facilities under CAD management are historic, those facilities require specialized preservation efforts and oversight. Secretary Gonzales also noted that some historic buildings are preserved using support from the private sector. If the GSD becomes the oversight entity for buildings under CAD management, Secretary Gonzales indicated that some private support for those buildings could be lost. She also expressed concern whether the GSD would be able to provide historic buildings with sufficient priority.

The committee members discussed a number of issues with Secretary Gonzales and Mr. Canney, including:

- any inquiries made to the Attorney General's Office with respect to the CAD's contract with Omni;
- whether the CAD had any other possible Procurement Code compliance issues outside of the scope of the Ribera project;
- the use of funds from general obligation bonds for libraries;
- possibilities for expediting the CAD's use of capital outlay funds;
- sources of funding for tribal libraries;
- the reasons for the state's purchase of the Ribera school house;
- strategies for development of a sustainable revenue source for CAD capital needs, while maintaining transparency;
- the SBF's process in approving sales of state property; and
- whether private funding for state historic buildings would be implicated by GSD oversight of those buildings.

Telecommunications Access Fund — Status and Concerns

Lisa Dignan, M.Ed., acting executive director, Commission for Deaf and Hard-of-Hearing Persons (CDHHP), and Shannon Smith, relay administrator, CDHHP, provided the committee with an update of the status of the Telecommunications Access Fund. Ms. Dignan explained that the source of money in the fund is the telecommunications relay service surcharge. The surcharge of .33 percent is imposed on the gross amount paid by customers for intrastate telephone services and intrastate mobile telecommunications services. Ms. Dignan estimated that distributions to the fund for FY 2013 would reach approximately \$2.7 million.

Ms. Dignan identified a number of challenges with regard to the sustainability of the existing revenue source for the fund. Consumers are increasingly using voice over internet protocol (VoIP) communications options, which are not subject to the surcharge. Thus, the fund balance has significantly declined. Ms. Dignan added that although New Mexico does not collect the surcharge from VoIP providers, consumers may access the services provided by the CDHHP, regardless of the phone service they use. According to Ms. Dignan, the federal government currently collects the interstate surcharge from VoIP providers.

Ms. Dignan indicated that wireless carriers have experienced difficulty in distinguishing between intrastate calls, which are subject to the surcharge, and interstate calls, which are not subject to the surcharge. The difficulty in isolating intrastate calls upon which the surcharge should be imposed likely has a negative impact on the balance of the Telecommunications Access Fund.

Ms. Smith reiterated the challenges with respect to the Telecommunications Access Fund and emphasized the CDHHP's desire to continue to provide adequate services to New Mexico's deaf and hard-of-hearing residents.

Committee members discussed several issues with Ms. Dignan and Ms. Smith, including:

- services offered by the CDHHP, including advocacy services, administration of the relay service, provision of interpreters and provision of specialized telecommunications equipment;
- federal funding for services to deaf and hard-of-hearing residents;
- challenges in obtaining timely payments from telecommunications providers;
- challenges in imposing the surcharge on customers who have moved to New Mexico from other states; and
- the potential to make innovative technological equipment available to the population served by the CDHHP.

Update on Selected Tax Expenditures

Secretary Padilla prefaced her discussion of selected tax expenditures by explaining that the TRD is in the process of updating its tax expenditure report and hopes to provide the updated report that will be completed by August. The TRD will seek to identify credits that are underutilized and determine why they are underused. The TRD also intends to determine the impact of recent changes on the overall use and efficiency of certain credits.

Secretary Padilla and Dr. Tysseling provided a number of statistics relating to the use of existing tax expenditures. They focused on the most used credits in New Mexico's tax structure. Dr. Tysseling indicated that the film production tax credit is the most used credit with an estimated revenue impact of \$50 million for FY 2013. The second most used credit is the high-wage jobs tax credit, with a total estimated revenue impact of approved or projected credits to be about \$22.1 million. However, Secretary Padilla explained that a number of existing credit

applications are currently under review. From the TRD's initial review of such applications, it appears that there are some duplicate applications, and it is likely that the figures associated with approved credits will change. The aggregate revenue impact for all tax expenditures in New Mexico could approximate \$104.7 million.

Next, Secretary Padilla and Dr. Tysseling provided the committee with an update on the use of the renewable energy production tax credit. Dr. Tysseling stated that the total credit claims could potentially approximate \$20 million per year, but the average annual claims received by the TRD usually fall below \$10 million. Between 2003 and 2015, the total maximum non-refundable tax credits earned could approximate \$129 million. Between 2009 and 2022, the total maximum of refundable credits earned could approximate \$149 million. Dr. Tysseling predicted that claims for renewable energy production tax credits could rise over the next several years as renewable energy projects become increasingly integrated into rural economic development plans.

The committee members and Secretary Padilla discussed whether a cap should be placed on the high-wage jobs tax credit. Secretary Padilla expressed that recent legislative changes to narrow application of the credit would, in her opinion, eliminate any need to cap the credit.

Tuesday, July 16

Trends in Tax Policy Issues Relevant to New Mexico

Helen Hecht, tax counsel, Federation of Tax Administrators, provided a report on trends in tax policy issues relevant to New Mexico, including trends affecting corporate income taxes and sales taxes, in addition to reviews of tax-incentive effectiveness and independent administrative hearings.

Ms. Hecht explained that states are moving toward "market-based" sourcing for all sales. The formula used to apportion a multistate business's income to New Mexico is based on the property, payroll and sales of the business, relative to a measure of all three factors for that business in all of the states in which it operates. The sales factor is the factor that most represents the market value of a business because the location of a business's customers is often where a service is performed or where a tangible cost is created. Thus, about one-half of the states have moved from "traditional" sourcing characterized by a three-factor formula to "market-based" sourcing. Many states are increasingly using a single sales factor. Ms. Hecht noted that the Multistate Tax Commission is currently developing uniform rules to assist with the implementation of "market-based" sourcing.

Next, Ms. Hecht described trends affecting sales taxes and gross receipts taxes. She explained that in 1992, the U.S. Supreme Court, in the *Quill* case, ruled that mail-order sellers without physical presence in a state could not be forced by that state to pay or collect a sales tax. However, since that decision, the U.S. Supreme Court held that a state may impose a sales tax on

a business that establishes a market for goods or services in that state through the use of contract representatives.

Ms. Hecht indicated that New York has amended its sales tax to ensure that an internet seller with a physical presence in the state and a web site would be required to collect the sales tax. Affected internet sellers, including Overstock and Amazon, challenged the law and lost in state court. The companies have been granted an extension to appeal to the U.S. Supreme Court.

Ms. Hecht described a similar case involving Barnes and Noble, and its internet entity, barnesandnoble.com. In that case, the internet entity was related to an entity with retail stores in New Mexico. The New Mexico Supreme Court found that the internet entity and the retail entity shared trade names, trademarks and marketing and promotional programs. The court held that the internet entity must pay gross receipts tax on sales to its customers in New Mexico.

Ms. Hecht stated that other states, such as Colorado, have passed laws to require internet sellers to report sales customers in their states. Internet sellers successfully challenged the Colorado law in federal court. However, the same case is currently on appeal. If Colorado prevails, other states might adopt similar laws to require remote sellers to provide information on their sales. Such laws would not necessarily require those sellers to collect a sales tax.

Ms. Hecht next indicated that lawmakers have increasingly become focused on the evaluation of state economic and tax incentives. The measure of a tax incentive includes whether the incentive accomplished the goal intended, but the measurement of the effectiveness of tax incentives is difficult because incentives cannot be rated in a laboratory-controlled environment. Despite this difficulty, states have found that the following reasons justify the review of the use of tax incentives:

- preventing abuse and unintentional or inadvertent inclusion (or exclusion) of taxpayers or activities;
- discovering reasons for the popularity of some incentives and examination of whether unused incentives should be eliminated;
- determining if a tax expenditure devoted to an incentive ought to be limited or capped;
- evaluating whether an incentive can be migrated to become part of the "fabric" of the tax itself; and
- imposing prospective reporting requirements.

The last tax policy trend discussed by Ms. Hecht involves independent administrative hearings. States are increasingly trying to provide for more independent administrative hearings in an effort to increase taxpayer confidence in the hearing process. The COST publishes a scorecard ranking states on the independence of their administrative hearing processes. While 30 states received an "A" or a "B" on the last scorecard, New Mexico received a "D". Ms. Hecht

stated that a hearing office independent from the TRD might improve the perception of independence with respect to the administrative hearing process for New Mexico taxpayers.

The committee members discussed the following issues with Ms. Hecht:

- whether sales could be sourced to the location of a business, rather than to the location of sales;
- the potential burden for internet sellers that might become responsible for tracking customer locations;
- the potential benefits to New Mexico businesses if a "market-based" apportionment formula is implemented;
- whether recent tax trends would promote fair treatment among taxpayers;
- perceived reasons for New Mexico's "D" rating in the COST scorecard;
- possible methods to achieve increased independence in New Mexico's administrative tax hearings; and
- methods to measure the effectiveness of tax incentives.

Current County and Municipal Tax Issues

Paul Gutierrez, executive director, New Mexico Association of Counties (NMAC), provided the committee with an overview of current issues affecting counties in the state. His discussion focused upon revenue sources for counties.

First, Mr. Gutierrez and Bill Fulginiti, executive director, New Mexico Municipal League (NMML), addressed current issues affecting county and municipal gross receipts tax revenues, including the impacts of the anticipated phaseout of "hold harmless" distributions to local governments. They explained that counties and cities are authorized to implement a tax on gross receipts at a rate of three-eighths percent under the existing law, and this tax was meant to permit local governments to offset losses from the elimination of hold harmless distributions. However, the hold harmless distributions will be phased out over a period of 15 years. For some local governments, the imposition of the three-eighths percent gross receipts tax will result in a revenue stream that exceeds the revenue stream that existed when only the hold harmless distributions were available. For others, imposition of the three-eighths percent tax could result in an expedited loss of hold harmless distributions and result in revenue losses. Mr. Gutierrez and Mr. Fulginiti indicated that the unintended consequences might be especially prevalent in some areas that are within both city and county limits. They also expressed concern that some counties and cities will benefit more than others as a result of the imposition of new local option gross receipts taxes and simultaneous hold harmless distribution phaseouts. Mr. Gutierrez and Mr. Fulginiti presented a chart containing the expected revenue impacts to New Mexico's counties and municipalities.

Next, Mr. Gutierrez called the committee's attention to the revenue impacts upon counties with respect to payments of state administrative fees in connection with the state's collection of county gross receipts taxes. He presented an analysis of the gross receipts tax increments

imposed by the various counties and noted that it is the NMAC's position that the state should consider removing all gross receipts deductions and exemptions, and possibly lowering the overall rates.

Mr. Gutierrez expressed concern about reduced funding for the County Detention Facility Reimbursement Fund. He noted that in the 2013 session, funding from House Bill 2 was reduced from \$4.9 million to \$3.3 million. Thus, the NMAC anticipates requesting a legislative initiative to provide for an increased gross receipts tax increment for detention facilities.

The NMAC is also working on an initiative with the New Mexico Realtors Association to address property tax lightning issues. In particular, Mr. Gutierrez indicated that the NMAC hopes to examine removal of the three percent cap on property values. Mr. Gutierrez indicated that while there may be winners and losers in the revaluation of individual properties, the NMAC anticipates that a reduction in mill rates could result.

Finally, Mr. Gutierrez discussed issues affecting other county funds, including the Local DWI Grant Fund. Mr. Gutierrez stated that an increased percentage of the liquor excise tax should be diverted to that fund. Moreover, he stated that an increased portion of insurance premium taxes should be distributed to the Fire Protection Fund. He explained that while reversions to the general fund from the Fire Protection Fund have been legislatively reduced, distributions to the Fire Protection Fund have not simultaneously increased. Mr. Gutierrez indicated that the NMAC hopes to return to a future committee meeting with a specific proposal to address this issue.

The committee members discussed a number of issues with Mr. Gutierrez and Mr. Fulginiti, including:

- the possible disparate impacts of the immediate imposition of the three-eighths percent gross receipts tax increment in various counties and municipalities;
- possible solutions for decreased funding with respect to sole community providers; and
- possible sources of additional funding at the state level for the Local DWI Grant Fund.

Gross Receipts Tax Take-Backs — Local Government Perspective and Update from the TRD

Mr. Fulginiti discussed how gross receipts tax "take-backs" have impacted various municipalities in the state. He explained that municipalities will receive gross receipts tax distributions from the TRD, which include their share of the state gross receipts tax, in addition to local option taxes imposed by the municipalities. At times, the TRD will take back a portion of those revenues and reduce distributions to municipalities. Mr. Fulginiti said the take-backs are used to correct erroneous distribution amounts made to municipalities in prior periods. He explained that the "errors" are not necessarily attributable to the TRD, but often arise due to

incorrect reporting by taxpayers. It is the NMML's position that Section 7-1-6.15 NMSA 1978 requires the state to absorb the cost of an erroneous distribution if the "error" is discovered more than one year after the distribution. Mr. Fulginiti explained that the TRD has a different interpretation. He stated that legislation was proposed in 2013 to alleviate the impacts of take-backs to municipalities. Mr. Fulginiti elaborated on impacts to specific municipalities.

Secretary Padilla and Nelson Goodin, chief counsel, TRD, presented the TRD's position on the same issue. Secretary Padilla stated that the TRD acknowledges the challenges that take-backs present to some municipalities. However, Secretary Padilla said it is the TRD's position that, pursuant to Section 7-1-6.15 NMSA 1978, take-backs do not signify any error for which the state must absorb the cost. According to the TRD, reduced distributions to municipalities due to take-backs reflect a correct and proper distribution of net receipts to municipalities. Secretary Padilla further stated that the TRD must administer the provisions of Section 7-1-6.15 NMSA 1978 as written and protect the general fund.

Secretary Padilla indicated that the application of Section 7-1-6.15 NMSA 1978 was recently litigated by the TRD before a district judge in Eunice. The judge ruled against the TRD, but the TRD is appealing that decision.

The committee discussed the following issues with Mr. Fulginiti, Secretary Padilla and Mr. Goodin:

- the role of taxpayers in creating the necessity for take-backs;
- the reasons for the recent court decision against the TRD;
- the possibility for legislative solutions to the problems inherent with gross receipts tax take-backs; and
- the possible negative effects of take-backs on small communities.

There being no further business, the committee adjourned at 11:55 a.m.